



New Issue: Moody's assigns Aa1 rating and stable outlook to City of Seattle Drainage and Wastewater revenue bonds

Global Credit Research - 24 May 2012

Approximately \$557.2 million of parity debt affected including current sale

SEATTLE (CITY OF) WA
Cities (including Towns, Villages and Townships)
WA

Moody's Rating

ISSUE	RATING
Drainage and Wastewater Improvement and Refunding Revenue Bonds, 2012	Aa1
Sale Amount	\$203,380,000
Expected Sale Date	06/04/12
Rating Description	Revenue: 501c3 Unsecured General Obligation

Moody's Outlook STA

Opinion

NEW YORK, May 24, 2012 --Moody's Investors Service has assigned an Aa1 rating and stable outlook to the City of Seattle's Drainage and Wastewater Improvement and Refunding Revenue Bonds, 2012 in the amount of approximately \$203.4 million. At the same time, Moody's affirms the Aa1 rating and stable outlook on the city's \$482.7 million of parity senior lien obligations. The bonds are secured by combined net revenues of the city's drainage and wastewater utility and any utility improvement district assessments (ULID assessments). Proceeds will be used for the utility's capital improvement program and to refund portions of the city's Series 2001, 2002, and 2004 parity obligations.

SUMMARY RATINGS RATIONALE

The Aa1 rating primarily reflects the utility's strong service area, which covers the City of Seattle (UTGO bonds rated Aaa/stable), and its well-maintained financial operations which benefit from active city management oversight. Also important to the rating assignment is the utility's sound debt service coverage, consistently above the internal target policy of 1.80 times.

The stable rating outlook is based on Moody's expectation that the city will continue to raise utility rates as necessary to maintain sound coverage levels in light of ongoing borrowing activity and increasing treatment costs.

STRENGTHS

- Stable, established customer base and service area
- Strong management with proven commitment to rate increases; access to sizable city-wide cash pool for liquidity
- Solid coverage levels maintained above internal target of 1.80 times

CHALLENGES

- High debt ration relative to peers
- Additional borrowing plans related to combined sewer overflow (CSO) projects

DETAILED CREDIT DISCUSSION

LARGE SERVICE AREA AND STABLE CUSTOMER BASE; LONG-TERM DOWNWARD TREND IN WATER CONSUMPTION MITIGATED BY REGULAR RATE INCREASES

The combined wastewater and drainage system serves the City of Seattle (Aaa/STA) and nearby suburban communities throughout the surrounding suburban King County (Aaa/STA). Seattle's population growth has been moderate, but steady increases in customers are expected to continue in the outlying areas. Water demand, however, has been decreasing as a result a greater focus being placed on conservation by Seattle and its wholesale customers. Between 2007 and 2011, wastewater volumes declined by an average of 1.5% per year.

The City of Seattle is the center of the Puget Sound region, and the commercial hub of the Pacific Northwest. The computer services and aircraft sectors are key components of the diverse regional economy. Seattle's economy remains on the recovery path because these primary employers continue to expand, and employment levels have almost completely recovered to pre-recession levels. Employment growth has been steady over the last two years, and the city's unemployment rate of 7.1% (February 2012) remains well below that of the state (9.1%) and the nation (8.7%). Full value per capita, at \$191,892, remains very high for a major metropolitan city. Wealth levels are also fairly high for a large city, with 2006 - 2010 estimated median family income of \$87,987, or 139.7% of the U.S.

SOLID FINANCIAL PERFORMANCE DRIVEN BY REGULAR RATE INCREASES, PRO-ACTIVE MANAGEMENT, AND STRONG FINANCIAL POLICIES

The city's proven willingness to raise rates and maintain debt service coverage exceeding the internal policy of 1.80 times is a key strength of the utility. Moody's anticipates that the utility will continue maintain sound debt service coverage of at least 2.0 times going forward. Debt service coverage ranged from 1.54 to 2.29 times between 2007 and 2011, was 2.21 times in 2011, and is conservatively projected to be 2.21 times in 2012. Coverage of peak debt service in 2017 is projected to be 2.19 times, and is supported by a well-established practice of prudent rate increases. Rate increases for the wastewater system have averaged 8.9% annually from 2007 to 2011, and were increased by 3.9% in January 2012. In 2008, the utility implemented a new drainage rate design to increase equity among wastewater and drainage customers, based on the size of their property. Since that time, residential and commercial drainage rates have averaged an increase of 11.8% and 19.5%, respectively, including an 11.4% increase in 2012. Unrestricted days cash on hand is a modest at 53 days in 2011. Moody's notes, however, that Seattle's utilities have access to sizable balances in the city-wide combined cash pool of about \$1 billion to meet liquidity needs.

The wastewater system currently serves a population of over 612,000, most of which are within the city limits. Residential accounts generated approximately 36% of total wastewater revenues in 2011. The drainage system serves approximately 213,000 accounts in a developed urban area, and has experienced limited customer growth in recent years; residential customers comprise 66% of total customers. In 2011 the ten largest customers accounted for 19.8% of drainage revenues, and included the City of Seattle, the Port of Seattle, King County, Seattle Public Schools, and the University of Washington.

King County (senior lien sewer revenue bonds rated Aa2) is responsible for sewage treatment and disposal and has entered into long-term contracts with local sewage agencies, including the City of Seattle, which remain responsible for their own local collection and transmission lines. The City's current agreement with the County expires July 1, 2036 and negotiations for a renewal or extension are currently underway. The County is currently nearing completion of a new 36 MGD treatment and reclaimed water plant ("Brightwater") and associated conveyance system at an estimated cost of \$1.8 billion, along with other projects including conveyance systems expanding the capacity of the South Treatment Plant, constructing 21 CSO projects, and controlling inflow and infiltration. The County finances the capital and operating costs of its sewage treatment and disposal system, with a wholesale charge to the City and other component agencies that is established by the County Council pursuant to the current agreement. Currently, the City's share of these costs is approximately 40%, and the utility passes the wholesale charge on to ratepayers. King County has implemented recent rate increases of 9.2% in 2007, 14.1% in 2009, and 13.2% in 2011, and is reflected in the City's corresponding increases in the same year. As a result of being a collection-only system and the contract with King County, the utility's operating ratio remains high relative to peers at 72.0% as the treatment cost is an O&M expense.

CAPITAL PLAN FOCUSES ON CSO AND FLOOD CONTROL PROGRAMS

The system's six-year capital improvement plan (CIP) for the 2012 through 2017 period totals \$585 million and is

projected to be 75% funded from bond proceeds, which is consistent with the city's internal policy of 25% cash financing. Accordingly, the utility's debt level is expected to remain above-average but is unlikely to exceed the adopted 70% debt ratio policy; the city's debt ratio in 2011 is 55.6% of assets. Much of the system's CIP addresses combined sewer overflow projects mandated by state and federal regulations that include large infrastructure projects (storage, pipes, tunnels, wet weather treatment plans and pump stations), smaller retrofits, and the construction of sustainable overflow control.

The bonds are secured by a senior lien pledge of net revenues of the city's wastewater and drainage system. The rate covenant is equal to 1.25 times annual debt service (including adjustments for rate stabilization draws and deposits). The additional bonds test is also 1.25 times. The debt service reserve fund requirement is equal to the lesser of maximum annual debt service or 125 percent of average annual debt service and will be funded with bond proceeds. Proceeds from the Improvement bonds will total approximately \$87.0 million and will be used toward the utility's capital improvement program. Proceeds from the Refunding bonds will total approximately \$116.4 million and will be used to refund all or a portion of the system's Revenue Bonds, Series 2001, Series 2002, and Series 2004.

Outlook

The stable rating outlook is based on Moody's expectation that the utility will continue to raise rates as necessary to maintain sound coverage levels as annual borrowing continues.

WHAT COULD MOVE THE RATING - UP

- Trend of extraordinary growth in operating revenue sources resulting in sustained healthy debt service coverage
- Significant increase in liquidity and reserves

WHAT COULD MOVE THE RATING -- DOWN

- Deterioration in pledged revenues and coverage
- Significant draw on available cash reserves
- Substantial increase in already high debt levels

KEY STATISTICS:

Service area population, 2008: 612,100

2006-10 median family income: \$87,987 (139.7% of state)

Wastewater customer account, 2011: 166,000

Drainage customer accounts, 2011: 213,000

Fiscal 2011 Ratios

Operating ratio: 72.0%

Annual senior lien debt service coverage: 2.21 times

Maximum annual debt service coverage: 2.19 times

Net working capital as a % of O&M expenditures: 17.5%

Days cash on hand: 53

Debt ratio: 55.6%

Payout of principal (10 years): 34.3%

The principal methodology used in this rating was Analytical Framework For Water And Sewer System Ratings published in August 1999. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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Analysts

Andrea Unsworth
Lead Analyst
Public Finance Group
Moody's Investors Service

Matthew A. Jones
Additional Contact
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA



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